PJM Interconnection, LLC

FERC/CFTC Joint Technical Conference

Credit Issues in the Energy Markets: Clearing & Other Solutions

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February 5, 2003

Background

- PJM Interconnection, L.L.C. is an RTO that operates a full set of markets
  - The markets are operated without profit, for the benefit of the Members
  - Cost of credit is borne by each Member, individually
  - Any default is passed directly to the Members, collectively
  - Diverse Membership with competing interests makes consensus agreement on Credit Policy difficult

- PJM bills monthly and settles on the 20th of the following month
  - Credit exposure may reach 60 days or more
  - Difficult to terminate a member that physically withdraws energy from the grid

PJM Credit Policy

- Developed through a stakeholder process
- Credit requirement is based on 2 months of peak activity
- PJM performs a financial evaluation of each Member
  - Establishes unsecured credit limits
  - Establishes collateral requirements, if needed
- PJM continually monitors Member activity

Issues

- Precipitous credit downgrades
- Cost - Risk tradeoff for Members
  - Minimize cost of providing collateral
  - Minimize probability of incurring cost due to covering a default
  - Should some collateral be required of all Members
- Providers-of-Last-Resort
  - PJM cannot terminate without FERC review and approval
- Multiple markets within PJM
  - Market designs may have unique credit requirements

Solutions Considered

No solution provides zero risk at zero cost for the Members

- Actions taken
  - More stringent unsecured credit criteria
  - Independent reviews of credit policy and procedures
    - Deloitte & Touche - completed
    - Standard and Poor's - in process
- Open issues
  - Consideration of a shorter settlement period
  - Insurance
  - Minimum collateral requirement for all Members

Market Needs

Creation of competitive wholesale markets introduced increasing credit risk

- Current needs
  - Reduce risk of open market defaults
  - Stabilize or reduce cost of providing collateral
  - Solidify confidence in Provider-of-Last-Resort default

PJM is open to any initiative that will reduce risk and increase liquidity in all markets, including bilateral and other energy marketplaces